

2005

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

Arizona Corporation Commission
DOCKETED

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AZ Corporation Commission
Director Of Utilities

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IN THE MATTER OF THE APPLICATION OF
ESCHELON OF ARIZONA, INC. FOR
APPROVAL OF ENCUMBRANCE OF ASSETS
PURSUANT TO A.R.S. § 40-285.

DOCKET NO. T-03406A-04-0868

DECISION NO. 67885

ORDER

Open Meeting
May 24 and 25, 2005
Phoenix, Arizona

BY THE COMMISSION:

On December 3, 2004, Eschelon Telecom of Arizona, Inc. ("Eschelon" or "Applicant") filed an application with the Arizona Corporation Commission ("Commission") requesting approval pursuant to A.R.S. § 40-285 to encumber certain of its assets in relation to the issuance of \$65 million of fixed rate Senior Second Secured Notes by its affiliated entity, Eschelon Operating Company ("Eschelon Operating").

On April 29, 2005, the Commission's Utilities Division Staff ("Staff") filed a Staff Report recommending approval of the application.

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. Eschelon is a Minnesota corporation and a wholly owned subsidiary of Eschelon Operating, which in turn is a wholly owned subsidiary of Eschelon Telecom, Inc. ("Eschelon Telecom").

2. Eschelon was granted a Certificate of Convenience and Necessity to provide facilities-based and resold interstate telecommunications services in Decision No. 62751 (July 25, 2000).

3. Decision No. 62751 ordered Eschelon to procure a performance bond equal to a minimum of 120 days intrastate revenue as well as any pre-payments or deposits collected from customers. Decision No. 62751 further ordered that the amount of the performance bond must be increased if at any time it would be insufficient to cover 120 days of intrastate telecommunications revenue, and the cumulative total of any prepayments and deposits collected from Eschelon's customers.

4. On March 9, 2005, the Commission issued Decision No. 67674, which modified Decision No. 62751 to amend the performance bond requirements for Eschelon. Decision No. 67674 ordered Eschelon to procure and maintain a performance bond of \$235,000, and to increase the performance bond if at any time it would be insufficient to cover advances, deposits, and or prepayments collected from its customers. Decision No. 67674 ordered that the bond amount shall increase in increments of \$117,500; that the increase shall occur when the total of the advances, deposits and or prepayments is within \$11,500 of the bond amount; and that while the Generic Docket on Bonding Requirement, Docket No. T-00000J-04-0912, remains pending the definition of "advances" for Eschelon's bonding requirement will not include monthly service charges billed in advance.

5. On April 18, 2002 in Decision No. 64737, Eschelon was granted a limited waiver of this Commission's Affiliated Interests Rules, A.A.C. R14-2-801 et seq.

6. As of December 31, 2004, Eschelon employed 53 people in Arizona, served 4,380 accounts in Arizona, and owned Arizona assets with a book value of \$4,359,613. According to the Staff Report filed in this docket, Eschelon's customer base in Arizona consists of small to medium size business and governmental accounts.

7. The asset encumbrance for which Applicant is requesting approval is related to a financing transaction by Eschelon Operating to fund the purchase price of an acquisition, the terms of which are governed by an Asset Purchase Agreement dated October 13, 2004. The application states that under the terms of the Asset Purchase Agreement, Eschelon Telecom will acquire substantially all of the assets of GE Business Productivity Solutions, Inc., and immediately transfer them to Business Productivity Solutions, Inc., a wholly-owned subsidiary of Eschelon Operating. In addition,

1 the financing by Eschelon Operating will fund Eschelon Telecom's acquisition of all of the issued
2 and outstanding common stock of ATI and SCS, which are subsidiaries of Advanced TelCom Group,
3 Inc. Upon completion of the transaction, Eschelon Telecom will be the new ultimate parent company
4 of Business Productivity Solutions, Inc., ATI and SCS. According to the application, the proceeds of
5 the financing will also be used for general corporate purposes, including the buy-back of some of
6 Eschelon Telecom's stock.

7 8. The application states that the financing transaction involves the issuance by Eschelon
8 Operating of \$65 million of 8 3/8 percent Senior Second Secured Notes that will mature on March
9 15, 2010, and that the obligations under the notes will be guaranteed by each state level operating
10 subsidiary, including Applicant, and that each operating subsidiary will grant a security interest in its
11 plant and equipment. The security interest with regard to Applicant will not become effective until
12 after issuance of this Decision approving the encumbrance.

13 9. Applicant states that the financing is part of an ongoing effort to provide Eschelon
14 Operating and its affiliates with flexibility to budget for capital expenditures and general corporate
15 purposes. According to the application, the funding provided by the financing will allow Eschelon
16 Telecom to better integrate the existing and acquired companies; improve the companies' operating
17 systems; bolster the companies' back office customer support activities; and enhance Eschelon
18 Telecom's liquidity, which will allow it to operate more efficiently.

19 10. Applicant asserts that approval of the application will enable Eschelon Operating to
20 obtain additional capital that will help Applicant to continue to offer competitive services in Arizona
21 and may allow it to expand its service offerings in Arizona, and is therefore in the public interest.

22 11. The application states that the proposed transaction will not result in an increase in
23 Applicant's maximum rates on file with this Commission.

24 12. The Staff Report states that the financing associated with the asset encumbrance
25 approval request will result in a highly leveraged entity on a consolidated basis with long term debt at
26 68.5 percent of capitalization. Staff states, however, that the highly leveraged position and pledge of
27 Arizona assets in support of the contemplated debt is not of concern to Arizona customers of
28 Eschelon, as those entities have many other choices for telecom services, and switching providers

1 would be relatively easy.

2 13. The Staff Report states that from January 2001 to the present, Eschelon has been the
3 subject of nine customer complaints and 16 inquiries, and that all customer complaints and inquiries
4 have been resolved.

5 14. Staff states that the pledge of assets and guarantee will not impair Eschelon's ability to
6 provide telecommunications services in Arizona. Staff believes that authorization of the pledge of
7 assets and guarantee in support of the financing transactions is warranted even though the
8 consolidated entity will be highly leveraged, because in the event of default or demise, many other
9 service providers are available to Eschelon's customers.

10 15. Staff recommends approval of Eschelon's request for authorization to pledge its assets
11 in support of loans in the amount of \$65,000,000 obtained by Eschelon Operating on the terms and
12 conditions described in the application, and recommends approval of Eschelon granting liens in favor
13 of the lender as required to secure the borrowings. Staff further recommends authorizing Eschelon to
14 engage in any transaction and to execute any documents necessary to effectuate the authorization
15 granted.

16 16. The proposed guarantee will enable Eschelon Operating and its affiliates to obtain
17 additional financing and capital to better integrate the existing and acquired companies; improve the
18 companies' operating systems; and bolster the companies' back office customer support activities.
19 The additional capital obtained will help Applicant to continue to offer competitive services in
20 Arizona and may allow it to expand its service offerings in Arizona. Although Eschelon's parent is
21 highly leveraged, that concern is mitigated by the availability of alternative providers to Eschelon's
22 Arizona customers, and by maintenance of a performance bond as set forth in Decision No. 62751 as
23 modified by Decision No. 67674. The performance bond shall continue to be maintained pursuant to
24 the requirements of that Decision, and shall not be reduced or eliminated unless otherwise ordered by
25 this Commission. The assets which comprise the performance bond as ordered by the Commission in
26 Decision No. 62751 as modified by Decision No. 67674 shall remain unencumbered.

CONCLUSIONS OF LAW

27
28 1. Eschelon is a public service corporation within the meaning of Article XV of the

Arizona Constitution and A.R.S. § 40-285.

2. The Commission has jurisdiction over Eschelon and the subject matter of the application

3. Authorization of Eschelon's encumbrance of assets in support of financing associated with the acquisition and corporate purposes described herein is compatible with the public interest.

4. Staff's recommendations in Findings of Fact No. 15 are reasonable and should be adopted, in addition to further orders below.

ORDER

IT IS THEREFORE ORDERED that, pursuant to A.R.S. § 40-285, Eschelon Telecom of Arizona, Inc.'s application for approval of encumbrance of assets as set forth in its December 3, 2004 application is hereby granted, with the exception that such encumbrance shall not include, or affect, the assets which comprise the performance bond as ordered by the Commission in Decision No. 62751 as modified by Decision No. 67674, and conditioned upon maintenance of the performance bond as required by the Commission.

IT IS FURTHER ORDERED that Eschelon Telecom of Arizona, Inc. is hereby authorized to engage in any transaction and to execute any documents necessary to effectuate the authorization granted

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.


CHAIRMAN

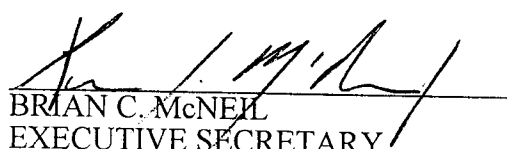

COMMISSIONER


COMMISSIONER


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COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 1st day of June, 2005.


BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____

TW ml

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